Supreme Court, U.S.
FILED

93 1869 MAY 24 1994

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No. 94-

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

JENNINGS WATER, INC.,
Petitioner,

v.

CSL UTILITIES, INC. and CSL COMMUNITY ASSOCIATION, INC.,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

7 U.S.C. § 1926(b) is part of a statutory scheme to promote the organization of rural water service associations and it prohibits the curtailment of the association's service by the inclusion of its service area within the boundaries of "any municipal corporation or other public body, or by the granting of any private franchise for similar service within such area during the term of such loan." The question presented is:

During the life of a federal loan, does 7 U.S.C. § 1926(b) prohibit a private water utility, which is a pre-existing wholesale customer of a federally indebted rural water association, from acquiring an alternative water supply to serve the utility's retail customers located within the rural water association's service area?

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PETITION FOR A WRIT OF CERTIORARI

The Petitioner, Jennings Water, Inc., respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit in this case.

OPINION BELOW

The Opinion of the Court of Appeals appears at 16 F.3d 130 (7th Cir. 1993) and appears in Appendix A as App. 1a-14a. The opinion of the District Court for the Southern District of Indiana appears at 807 F. Supp. 490 (S.D. Ind. 1992).

JURISDICTION

The judgment of the Court of Appeals was entered on December 15, 1993. The petitioner's motion for a rehearing was denied on February 25, 1994 and the Court's

December 15, 1993 opinion was modified as appears in Appendix B as App. 15a-16a. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATEMENT

The facts are set out in the two previous Court of Appeals decisions in this case. *Jennings Water, Inc. v. City of North Vernon*, 895 F.2d 311 (7th Cir. 1989) (*Jennings I*) and *Jennings Water, Inc. v. CSL Utilities, Inc. and CSL Community Association, Inc.*, 16 F.3d 130 (7th Cir. 1993) (*Jennings II*). The case arose under a federal statute, 7 U.S.C. § 1926(b), and the United States District Court for the Southern District of Indiana, Indianapolis Division, had subject jurisdiction matter pursuant to 28 U.S.C. § 1331.

Jennings Water Company (Jennings) is a rural not-for-profit water association formed in 1975 by the merger of two rural water companies, Geneva Township Water Corporation (Geneva) and Muscatatuck Water, Inc. (Muscatatuck). Both Geneva and Muscatatuck were financed by loans granted by the Farmers Home Mortgage Administration (FmHA) pursuant to 7 U.S.C. § 1926. In 1977, Jennings assumed Geneva's initial loan of one hundred eighty-one thousand dollars ($181,000) and obtained an additional loan, with a forty year term, to expand its water treatment, storage and distribution facilities. Jennings currently serves 2000 customers in Jennings County, Indiana. As of 1989, Jennings' outstanding indebtedness to the FmHA was "just under $1.5 million." 895 F.2d at 313.

CSL Utilities (CSL) is Jennings' largest customer. CSL is a private investor owned utility company and serves only the residents of Country Squire Lakes, a subdivision in Geneva Township in Jennings County. CSL serves 300 permanent and 850 seasonal residents. In 1974, CSL began purchasing water from Geneva and continued to purchase water from Jennings after the merger.

CSL refused to a sign a $100,000.00 water purchase agreement requested by the FmHA as a condition for the FmHA-Jennings loan. However, since its formation, Jennings has continued to provide CSL with all of its water on a month to month basis. 895 F.2d at 313.

The controversy that led to the present litigation began in 1986 when Jennings notified CSL that Jennings would seek a rate increase from the Indiana Public Service Commission. After the Indiana PSC approved a substantial rate increase, CSL entered into an agreement with the city of North Vernon, Indiana to purchase a substitute supply. After consultation with the FmHA, Jennings objected to the completion of the North Vernon-CSL water main and the proposed purchase agreement because its revenue base would be significantly eroded. The District Court for the Southern District of Indiana enjoined the sale of water to CSL because 7 U.S.C. § 1926(b) prohibits municipal encroachment of the service area of a rural water association during the term of the loan. *Jennings Water, Inc. v. City of North Vernon*, 682 F. Supp. 421 (S.D. Ind. 1988). The Seventh Circuit Court of Appeals affirmed. *Jennings Water, Inc. v. City of North Vernon*, 895 F.2d 311 (7th Cir. 1989) (*Jennings I*).

During the appeal in *Jennings I*, CSL decided to pursue an alternative strategy to obtain a substitute water supply. It filed a complaint in the United States District Court for the Southern District of Indiana seeking a declaratory judgment that 7 U.S.C. § 1926(b) permitted the construction of its own reservoir, purification and distribution system to serve its retail customers. On August 9, 1988, *Jennings* filed a motion to dismiss arguing that the district court opinion in *Jennings I* barred the complaint because it was res judicata and collaterally estopped CSL. After the District Court denied Jennings motion to dismiss, CSL filed a motion for summary judgment and Jennings filed a cross motion for summary judgment.

Jennings' cross motion was granted by the District Court. On December 15, 1993 the Seventh Circuit Court of Appeals reversed the District Court. *Jennings Water, Inc. v. CSL Utilities, Inc. and CSL Community Association, Inc.*, 16 F.3d 130 (7th Cir. 1993) (*Jennings II*); App. 1a-14a.

The Court of Appeals held that CSL was within Jennings' service area because all previous retail and wholesale customers served by an association at the time of its formation are within its service area. The Court of Appeals also held that CSL's decision to discontinue purchasing water from Jennings occurred "during the term of such loan," as defined in 7 U.S.C. § 1926(b). In doing so, the Court of Appeals held that though CSL was incorporated in 1974 prior to the creation of Jennings, Jennings' assumption of a predecessor association's 1965 loan brought Jennings within the scope of the statute's protection. However, the Court of Appeals held that the statute does not prohibit a wholesale customer from improving its own facilities to serve at retail because allowing the new service "would not confer a right to serve new customers or to provide a different service." 16 F.3d at 136; App. 11a.

STATUTE INVOLVED

7 U.S.C. § 1926(b) Curtailment or limitation of service prohibited

> The service provided or made available through any such association shall not be curtailed or limited by inclusion of the area served by such association within the boundaries of any municipal corporation or other public body, or by the granting of any private franchise for similar service within such area during the term of such loan; nor shall the happening of any such event be the basis of requiring such association to secure any franchise, license, or permit as a condition to continuing to serve the area served by

the association at the time of the occurrence of such event.

REASONS FOR GRANTING THE PETITION

I. THE DECISION BELOW INCORPORATES AN UNWARRANTED MARKET COMPETITION POLICY INTO 7 U.S.C. § 1926(b) WHICH UNDERMINES THE PURPOSE AND SCOPE OF THE STATUTE AND IS INCONSISTENT WITH THE DECISIONS OF ALL OTHER COURTS OF APPEAL AND DISTRICT COURTS INTERPRETING 7 U.S.C. § 1926(b)

7 U.S.C. § 1926(b) protects rural water associations indebted to the Federal Government by creating a pervasive scheme of entry barriers to allow the association to sustain itself financially so that it can discharge its federal debt obligation. The statute creates no express exemptions to permit the entry of competitors to serve the rural water association's customer base at the time it became indebted to the Federal Government. However, the Court of Appeals decision below read the statute to allow a court to decide when to permit new entrants into the utility's market to prevent unfair hardships on competing utilities. This assertion of judicial discretion is unwarranted by the language and purpose of the statute. The Court of Appeals decision below undermines the purpose of the statute. Ad hoc judicial entry standards discourage the formation of rural water associations by increasing the risks that they will be unable to meet their federal debt service obligations. The decision of the Court of Appeals is also a major departure from both general principles of public utility law, reflected in 7 U.S.C. § 1926(b), which justify the imposition of entry restrictions on competing utilities, prior lower court decisions interpreting the purpose and scope of the statute and this Court's statutory construction jurisprudence.

Sections 1921 to 2006 of Title 7 of the United States Code create a federal loan program administered by the

Farmers Home Administration (FmHA) to promote agriculture and rural development. The FmHA "is an agency within the Department of Agriculture providing credit to those unable to get credit from other sources at reasonable rates and terms." Julian Conrad Juerensmeyer and James Bryce Wadley, AGRICULTURAL LAW § 14.4 (1982). Section 1926 provides a federal loan program for a variety of water and soil conservation programs including the organization of rural water associations. Title 7 is an exercise of the Federal Government's spending power. The FmHA is acting in a sovereign capacity when it makes loans to rural water associations. *Somerville Technical Services v. United States*, 640 F.2d 1276, 1281 (Ct.Cl. 1981).

In 1961, the loan program was extended to rural water associations serving non-farm residents. Rural water associations are authorized to serve both farm and rural residential customers. When Congress extended the loan program, it enacted Section 1926(b) of Title 7. This section is the linchpin of the federal loan program because it protects both the Federal Government's interest in the timely repayment of its loans and the utility's provision of reliable and safe water supplies for domestic consumption and use by the intended program beneficiaries. These purposes are served by the standard rationale for public utility regulation: sufficient economies of scale exist in the provision of an essential service so that the relevant market is best served by a single entity. Entry restrictions must only be reasonably related to some plausible governmental interest. *New Motor Vehicle Board of the State of California v. Orrin W. Fox Co.*, 439 U.S. 96 (1978).

Section 1926(b) protects the service area of a federally indebted rural water association by prohibiting competing utilities from offering alternative service. The section mandates that the service provided by these associations "shall not be curtailed or limited by the inclusion of the area served by such association within the boundaries of

any municipal corporation or other public body, *or by the granting of any private franchise for similar service within such area during the term of such loan.*" 7 U.S.C. § 1926(b). Our emphasis. Congress enacted the section "to assist in protecting the territory served by such an association facility against competitive facilities, which might otherwise be developed with the expansion of the boundaries of municipal and other public bodies into an area served by the rural system." 2 U.S. Code Cong. & Admin. News, 87th Cong., pp. 2309 (1961).

The Seventh Circuit found the entry restriction an "extreme application" of Section 1926(b) because the statute only protects indebted utilities from competition from non-customer third parties and drew a distinction between the creation of a new franchise and the exercise of an existing one. The rationale for this narrow and novel reading of the statute is not fully articulated. The apparent rationale is that by failing to be more explicit, Congress impliedly exempted wholesale customers who seek to improve their own facilities "so as to reduce the amount of water it must purchase wholesale," 16 F.3d at 136; App. 10(a). The opinion below found that this form of service competition is not encompassed in the statutory prohibition against new service which injures a federally indebted association. The supporting reasons appear confined to (1) an assertion in footnote no. 2 that "[*i*]*n general*, we think that a franchise to serve at retail carries with it power to vertically integrate to provide for water supply." (emphasis added), 16 F.3d at 136, App. 10(a), and (2) the unsupported conclusion that a contrary construction of the statute would impose "a significant and seemingly unfair hardship upon the utility by denying it the right to develop its own facilities to service its existing customers more economically." 16 F.3d at 137; App. 14(a).

The Seventh Circuit's distinction and rationale is inconsistent with prior circuit court decisions, general principles of public utility law and this Court's rules of statu-

tory construction. The Fourth, Fifth, Tenth and Seventh Circuit Courts of Appeal (*Jennings I*) have interpreted Section 1926(b) to protect a federally indebted association's pre-existing territory from all subsequent competition. The facts of the cases happen to involve non-customer third parties. None of the cases contain any suggestion that the association's protection from competition is limited to this situation. Nor do they contain any suggestion that an association's protection depends on the timing of a competing utility's decision to serve the association's customers. CSL's proposed water production, treatment and service facilities within a federally indebted rural water association's service area are prohibited within the meaning of 7 U.S.C. § 1926(b) regardless of whether it is labeled new or expanded. The statute expressly protects an association from all utility competition, public or private if a federally indebted rural water association will experience service curtailment during the life of the loan. As the Seventh Circuit stated in *Jennings I*, "section 1926(b) . . . absolutely bars any encroachment by a competing water system on a rural water system indebted to the FmHA." 895 F.2d at 318, n.6.

Previous courts of appeal decisions have held that the efforts by other water service utilities to supplant a rural water association or to compete with it must be strictly limited during the term of the loan in order to carry out the two major interests sought to be advanced by the statute. First, the statute seeks to provide reliable and safe service to rural water users. Second, the statute ensures that the indebted utility's financial ability to repay the federal loan will not be impaired. *City of Madison, Mississippi v. Bear Creek Water Ass'n, Inc.*, 816 F.2d 1057, 1060 (5th Cir. 1987).

Previous courts of appeal have rejected literal readings of the statute and instead have used general principles of public utility law to interpret the statute to achieve these purposes. This is consistent with this Court's continued adherence to the rule that a statute must be construed

with reference to its language, structure, object and policy. *U.S. National Bank of Oregon v. Independent Insurance Agents of America*, —— U.S. ——, 113 S.Ct. 2173, 2182 (1993). For example, the Fifth Circuit Court of Appeals held that a city can not condemn a substantial percentage of a utility's customers and facilities even though Section 1926(b) does not expressly prohibit condemnation. "The statute unambiguously prohibits any curtailment or limitation of an FmHA-indebted water associations services resulting from municipal annexation or inclusion." *City of Madison, supra* at 1059. The Tenth Circuit Court of Appeals reached a similar conclusion. *Glenpool Utility Services v. Creek County Rural Water District*, 861 F.2d 1211 (10th Cir. 1988), cert. denied, 490 U.S. 1067 (1989).

Federal district courts have also read the statute broadly and have not limited it to protection from municipal third parties. The United States District Court for the Northern District of Oklahoma has characterized the purpose of the statute as the protection of associations from "competitive facilities," especially those which would be developed as a result of the expansion of the "neighboring municipalties or other public bodies into an area served by the rural water association." *Rural Water District # 3 v. Owasso Utilities Authority*, 530 F. Supp. 818, 823 (N.D. Okla. 1979). Consistent with the broad competition protection mandate of the statute, federal district courts have rejected the necessity to prove actual economic prejudice from a specific anti-competitive decision. Furthermore, the statute prevents the "piecemeal erosion" of the area served by a rural water association. *Moore Bayou Water Association v. Town of Jonestown*, 628 F. Supp. 1367, 1370 (N.D. Miss. 1986).

Prohibiting a federally indebted rural water association's wholesale customer from serving its customers with an alternative water supply is consistent with accepted public utility theories which deny new competitors entry into a protected market. 7 U.S.C. § 1926(b) contains no invita-

tion to courts to fashion a federal common law of competition promotion. To the contrary, an indebted utility is exempt from the Sherman Act because of the "state action" exemption. *Pinehurst Enterprises, Inc. v. Town of Southern Pines*, 690 F. Supp. 444 (M.D.N.C. 1988), aff'd, 887 F.2d 1080 (4th Cir. 1989). Prior to the decision of the Court of Appeals below, courts have assumed that an association is protected from all direct and indirect service competition with its customers. For example, the United States District Court for the Northern District of Oklahoma has held that a second utility may only enter an association's service area where it provides water for a use not provided for by the association. *Rural Water District # 3 v. Owasso Utilities Authority*, 530 F. Supp. 818, 823 (N.D. Okla. 1979) (fire protection).

The construction of the statute to prevent a franchised utility from entering an association's service area is consistent with accepted principles of public utility regulation which are incorporated into the statute. CSL desires to enter Jennings' service area because it perceives an opportunity for "cream skimming." Because of its compact proposed service area, CSL may provide service at a lower cost. The ability of a second service provider to exploit a small, particularly profitable niche of a utility's larger service area has been characterized as "cream skimming" because the new entrant is not burdened with the first provider's large fixed costs incurred in order to serve a larger area. Ernest J. Gellhorn and Richard J. Pierce, Jr., REGULATED INDUSTRIES pp. 281-283 (1982). The net result is to impose higher rates on the remaining customers of the first provider. This Court has long held that the prevention of "cream skimming" is a valid basis for Congressional legislation to deny or to regulate market entry. See the concurring and dissenting opinions of Mr. Justice Frankfurter in *Atchison, Topeka & Santa Fe R. Co. v. Reddish*, 368 U.S. 81, 135 (1961); *Interstate Commerce Commission v. J-T Transport Company*, 368 U.S. 81, 95 (1961) (Frankfurter J., dissenting). Con-

gress made an explicit decision to prohibit all competing service for the life of the loan. 7 U.S.C. § 1926(b) is not a statute intended to promote competition in rural water service during the life of a federal loan; it is a statute intended to attract and finance monopolies in "thin" rural markets.

The Seventh Circuit's recognition of a market entry interest in CSL is both contrary to the purpose of 7 U.S.C. § 1926(b) and previous circuit courts of appeal decisions interpreting it. CSL is a public utility. This Court has previously held that a proprietary water service company becomes a public utility when it is "devoted to supplying a large community with a prime necessity of life." *Van Dyke v. Geary*, 244 U.S. 39, 47-48 (1917) (interpreting Arizona law). Thus, CSL is entitled only to service rights recognized by statute or the Constitution. Any state-created rights that CSL can claim are limited by 7 U.S.C. § 1926(b). The statute confers no express or implied service rights on competing utilities. No constitutional right exists. In *Glenpool Utility Services, supra* at 1215, the Tenth Circuit Court of Appeals dismissed the argument that a FmHA loan to a rural water association unconstitutionally contracts away a property interest in a competing utility. The decision of the Court of Appeals below also found CSL's constitutional arguments without merit. 16 F.3d at 137, fn. 3; App. 14a.

II. THE DECISION BELOW UNDERMINES THE FEDERAL GOVERNMENT'S ABILITY TO SECURE REPAYMENT OF ITS LOAN TO NOT-FOR-PROFIT ASSOCIATIONS AND IS THUS INCONSISTENT WITH THIS COURT'S CONSISTENT EFFORT TO FACILITATE THE COLLECTION OF FEDERAL DEBTS AND TO AFFORD THE FEDERAL GOVERNMENT THE PROTECTIONS FROM UNASSUMED FINANCIAL RISKS AND BURDENS PROVIDED BY THE CONSTITUTION AND THE COMMON LAW

When the FmHA makes a loan to a rural water association, an ordinary mortgagor-mortgagee relationship is created between the FmHA and the association. 7 U.S.C. § 1927(c).* The association executes a mortgage to the FmHA and obligates itself to repay the loan over forty years. The Federal Government has the usual powers of a mortgagee to ensure the repayment of its loan. As mortgagee, the FmHA is entitled to protection against increases in repayment risks subsequent to the execution of the mortgage. For example, to protect mortgagees from interest rate declines, there is no common law right to prepay a mortgage. George E. Osborne, Grant S. Nelson and Dale A. Whitman, REAL ESTATE FINANCE LAW § 6.1 (1979). The protection of the FmHA's repayment interest is especially important in this loan program because the Secretary of Agriculture is primarily limited to loans in areas with cities of less than 10,000 inhabitants, 7 U.S.C. § 1926(a)(7), and thus these loans carry a higher risk compared to loans for utilities in more densely populated areas.

The FmFA and an association assume the risk of a fluctuating customer base as individual customers choose to discontinue service. However, these are small risks inherent in any public utility service and substantially different from the risk imposed by the decision of the

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* The Court may wish to solicit the views of the Federal Government on the impact of the Seventh Circuit's decision on FmHA loans to rural water associations throughout the country.

Court of Appeals below. The FmHA and an association are not required to assume the risk that additional utilities will be authorized to compete in the service area. *City of Madison, supra.* This post-loan risk impairs the association's repayment capability and the FmHA's ability to obtain repayment as Congress intended. The Court of Appeals conclusion that CSL was not granted a new franchise but only sought to exercise its pre-existing one in a "particular (and new) fashion" creates a distinction which impairs both the association's repayment capability and the FmHA's interest in timely repayment. The FmHA has an interest in maintaining the level of repayment risk that existed at the time of the loan. Without any foundation in legislative history or prior judicial interpretations of 7 U.S.C. § 1926(b), the Seventh Circuit has converted a statute intended to preserve the *status quo* into a market entry regime that allows private developers to compete with the association within its service area during the federal loan term.

By its failure to observe this basic distinction in public utility law, the Seventh Circuit creates a federal common law of competition in contravention of Congress' desire to prevent competition for the life of the federal loan. This invitation to use the statute as a basis for a new federal common law is inconsistent with the many decisions of this Court which seek to protect the integrity of the federal fisc from state and judicial intrusions which are inconsistent with congressional mandates. To protect the federal government's interest in debt recovery, this Court follows a presumption that Congress intended to give federal agencies ample power to collect debts owed them. In *United States v. Texas*, 113 S.Ct. 1631 (1993), for example, this Court recently held that the Debt Collection Act of 1982 does not preclude the United States from collecting prejudgment interest on a debt incurred through participation in the Food Stamp Program because "The Act was designed "[t]o increase the efficiency of Government-wide efforts to collect debts owed to the United

States . . . ." 113 U.S. at 1636. This Court further noted that a contrary reading "would have the anomalous effect of placing delinquent States in a position where they had less incentive to pay their debts to the federal government than they had prior to its passage." *Ibid.*

The decision of the Court of Appeals below creates a similar anomaly because it invites the creation of a federal common law of exceptions to the market entry prohibition mandates of the statutes dealing with relations between the Federal Government and persons indebted to it. Thus, the precedent progressively increases the Federal Government's risk of default above that which it assumed at the time that it extended the loan. Federal judicial protection of the FmHA's repayment interest is especially necessary under this program because the structure of the program does not include repayment protections found in other federal loan programs. For example, under the Reclamation Act of 1902, before reclamation water or contract rights are transferred, the Department of Interior's practice is to interpret Bureau of Reclamation contracts to allow project beneficiaries to transfer project rights provided that the transferee assumes the transferor's repayment obligations. 3 WATERS & WATER RIGHTS § 160.03 (b)(2) (R. Beck ed. 1991).

This Court has consistently guarded the public fisc by requiring an express showing of congressional waiver of sovereign immunity to allow states to assess fees against the Federal Government. In the 1992-93 term, this Court reaffirmed that the McCarran Amendment waives the sovereign immunity of the United States for both state adjective law and the substantive law of water rights. However, the Amendment's waiver does not extend to state filing fees because "[a]s to monetary exactions . . . we have been particularly alert to require a specific waiver of sovereign immunity . . . ." *United States v. Idaho, ex rel. Director, Idaho Department of Water Resources,* —— U.S. ——, 113 S.Ct. 1893, 1897 (1993); see also *United States Department of Energy v. Ohio,* 112 S.Ct.

1627, 1633 (1992). The decision of the Court of Appeals below is counter to this fundamental principle inherent in sovereign immunity. In the absence of the specific congressional intent to subject the United States to fiscal liability as required by this Court, the Seventh Circuit has opened the door to a series of judicial exceptions to a strong congressional mandate that the federal interest in loan repayment requires that federally indebted rural water associations should be protected from competition during the life of the loan. As the Court of Appeals for the Tenth Circuit noted in *Glenpool Utility Services*, Section 1926(b) protects "federal funds advanced under the congressional spending power and pursuant to a national policy concerned with water management and rural populations." 861 F.2d 1211 at 1215.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDICES

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 92-3026

CSL UTILITIES, INCORPORATED and
CSL COMMUNITY ASSOCIATION, INCORPORATED,
Plaintiffs-Appellants,

v.

JENNINGS WATER, INCORPORATED,
Defendant-Appellee.

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division
No. 88 C 1151—Sarah Evans Barker, *Judge*

ARGUED JANUARY 13, 1993—
DECIDED DECEMBER 15, 1993

Before CUDAHY, FLAUM, and MANION, *Circuit Judges.*

CUDAHY, *Circuit Judge.* The plaintiff, a nonprofit water utility company, seeks a declaratory judgment that its planned development of a water system does not violate the federal statutory scheme that provides for the extension of loans to certain rural water associations and protects such associations from infringement upon their

services. The defendant, a rural water association indebted to the government under the loan program, contends that the plaintiff's system would encroach on the defendant's service and thus curtail it under the terms of 7 U.S.C. § 1926(b). The parties filed cross motions for summary judgment and the district court, concluding that the plaintiff's plans constituted a violation of section 1926 (b), granted the defendant's motion for summary judgment and denied the plaintiff's. We reverse.

I.

The defendant, Jennings Water, Inc., is a rural nonprofit water association in Jennings County, Indiana. It was formed in 1975 through the merger of two local rural water companies, Geneva Township Water Corporation and Muscatatuck Water Corporation, that were financed by loans from the federal Farmers Home Administration (FmHA). Jennings assumed those loans—which in Geneva's case dated back to 1965 and in 1977 obtained another loan from the FmHA to connect and expand water treatment, storage, and distribution facilities. The term of the 1977 loan is 40 years.

The plaintiff, CSL Utilities, Inc., is a private nonprofit utility company formed in 1974 to supply water at retail to the residents of a Jennings County subdivision called Country Squire Lakes. Initially CSL was supplied wholesale water by Geneva. In 1977, when Geneva and Muscatatuck merged to create Jennings, Jennings became CSL's supplier. CSL is Jennings' major wholesale customer and has purchased water from Jennings since Jennings' inception.

In March 1987, the Indiana Utility Regulatory Commission approved a substantial rate increase—nearly 100 percent—for Jennings. In response, CSL first attempted to purchase water from neighboring North Vernon, Indiana, but the district court, *see Jennings Water, Inc. v. City of North Vernon*, 682 F. Supp. 421 (S.D. Ind. 1988), and

this court on appeal, *see Jennings,* 895 F.2d 311 (7th Cir. 1989), found that the arrangement would violate 7 U.S.C. § 1926(b). That provision, which is part of a federal statutory scheme to extend loans to certain associations providing water service or management or other essential community services to rural residents, prohibits encroachment on the service provided by rural water associations that hold FmHA loans.

This lawsuit involves CSL's alternative attempt to secure another water source by constructing its own water purification and delivery facility; CSL claims this addition would supplement but not eliminate its purchase of water from Jennings. CSL completed the necessary engineering studies, filed an application to build the facility, and sought a declaratory judgment that the development of the water system to serve Country Squire Lakes residents would not violate section 1926(b).

Both CSL and Jennings fiied motions for summary judgment. The district court denied CSL's motion and granted Jennings' motion. While the district court and this court in the initial suit rejected CSL's arrangement with North Vernon on the basis of section 1926(b)'s language prohibiting curtailment "by inclusion of the area served by [Jennings] within the boundaries of any municipal corporation or other public body," the district court in the present case held that CSL's plans constituted a violation of another part of section 1926(b), which prohibits curtailment of Jennings' service "by the granting of any private franchise for similar service within such area during the term of such loan." CSL appeals.

II.

The statute at issue, which purports to protect the customer base of rural water associations, provides:

> The service provided or made available through any such association shall not be curtailed or limited by inclusion of the area served by such association

> within the boundaries of any municipal corporation or other public body, or by the granting of any private franchise for similar service within such area during the term of such loan; nor shall the happening of any such event be the basis of requiring such association to secure any franchise, license, or permit as a condition to continuing to serve the area served by the association at the time of the occurrence of such event.

7 U.S.C. § 1926(b). The application of this statute to preclude a wholesale customer of an association from constructing a facility to provide its own water supply presents close and difficult questions. The private franchise restriction at issue under the statute has three components: (1) the curtailment of the association's service area (2) by a private franchise (3) that was granted during the term of the FmHA loan. On appeal, CSL contests all three of these requisites arguing, *inter alia,* that construction of its proposed water treatment and delivery facility would not curtail the "area served" by Jennings, that construction of a such a facility by an existing utility does not constitute the grant of a private franchise, and that CSL's private franchise was not granted "during the term of such loan." We address each contention separately.

"The Area Served"

CSL's first suit ivolving its arrangement with North Vernon (which we will call *Jennings I*) established that such a deal with a municipality would be a prohibited curtailment "of the area served . . . within the boundaries of any municipal corporation or other public body." 7 U.S.C. § 1926(b). The present case involves the interpretation of a different clause in section 1926(b) that prohibits curtailment "by the granting of any private franchise for similar service within such area during the term of such loan." *Id.*

Although the two clauses address similar but distinct economic concerns, they share the reference to the "area served by [Jennings]." The district court in *Jennings I* explicitly rejected CSL's argument that the Country Squire Lakes subdivision was not in Jennings' (wholesale) service area because it comprised CSL's (retail) service area. 682 F. Supp. at 424. This court affirmed the district court, noting the "uncontroverted evidence establishing that CSL was 'served' by Jennings at the time of the 1977 FmHA loan (and for the following decade)." 895 F.2d at 318.

CSL contends that the inquiry differs in the context of the "private franchise" clause of section 1926(b). The plain terms of the statute contradict that contention, however. While the "municipal corporation" clause prohibits the curtailment or limitation "of the area served by such association," the "private franchise" clause prohibits curtailment by the granting of any private franchise "within *such* area" (emphasis added). The use of the term "such" signifies that the phrase has the same meaning as it does when it is first mentioned in the "municipal corporation" clause.

CSL concedes that construction of the water treatment facility will curtail the amount of water it purchases from Jennings. Even if CSL has no desire or intent to become a permanent part of Jennings' service area or the CSL-Jennings wholesale agreement is purportedly "temporary," it is beyond dispute that CSL and the Country Squire Lakes residents are presently in Jennings' wholesale service area and are, in addition, served by Jennings for the purposes of the "private franchise" clause as well as of the "municipal corporation" clause. The issue here is not so much the scope of the service area as it is the right of a wholesale customer serving at retail to improve its own facilities to curtail or eliminate the need for wholesale supply. We address that difficult issue below.

"During the Term of Such Loan"

In this connection, the second of three prerequisites to establishing a violation of the "private franchise" clause is that the curtailment result from the granting of a private franchise. We will explore the "granting of a private franchise" in greater depth below, but temporarily CSL might have been granted a franchise at its incorporation and may be given a franchise upon receiving authorization to improve its facilities. CSL originally was granted a private franchise at its incorporation in December 1974. There is a dispute whether CSL was granted this franchise "during the term of [the FmHA] loan"—the third requirement. According to CSL, its private franchise falls outside the language of section 1926(b) because it was granted before the term of the 1977 FmHA loan to Jennings and in fact before Jennings even existed. Jennings counters that its assumption of the Geneva loan predating CSL's franchise entitles it to section 1926(b)'s protection; in the alternative, or at least seemingly so, Jennings argues that the presently contemplated construction of CSL's water facility—more specifically, the state agencies' approval that is required to build and finance the water treatment facility—constitutes the granting of a private franchise that unquestionably occurred during the term of Jennings' own FmHA loan.

We turn first to the assumption issue. On October 21, 1977, after Geneva and Muscatatuck merged to create Jennings, Jennings assumed Geneva's FmHA loans, which dated back to November 1965.[1] CSL contends that it

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[1] The assumption agreement provides:

> The provisions of said debt and security instruments and of any outstanding agreements executed or assumed by the present debtors pertinent thereto shall, except as modified herein, remain in full force and effect, and the assuming parties hereby assume the obligations of and agree to be bound by and to comply with all covenants, agreements and conditions contained in said instruments and agreements, except, as modified herein, the same as if they had executed them as of the dates

cannot possibly be poised to violate section 1926(b) when *Jennings'* 1977 loan, as opposed to Geneva's loans that Jennings assumed, was secured after CSL became a private franchise. This formalistic interpretation finds no support in the language of section 1926(b) and contravenes the statute's purposes to encourage rural water development by expanding the number of potential users and to safeguard the financial viability of rural associations and FmHA loans. *See Jennings I*, 895 F.2d at 315 (citing *City of Madison v. Bear Creek Water Ass'n, Inc.*, 816 F.2d 1057, 1059 (5th Cir. 1987)). The absence of any textual reference to assumption of loans tends to support the conclusion that such a transfer does not alter the statute's scope of protection rather than CSL's view that it does. We agree with the observation of the court below that CSL fails to explain "why an agreement between the FmHA and an association to make a loan is an operative event for analyzing section 1926(b) but an agreement between the FmHA and an association to assume a loan should have no effect." Order at 8. Thus, CSL was granted a private franchise during the term of Jennings' loan from the FmHA.

"The Granting of any Private Franchise for Similar Service"

This brings us to what we believe is the key issue before us. Will the curtailment that is contemplated here result from the "granting of any private franchise for similar service?" If we assume that the "private franchise" involved here is the one granted at the formation of CSL in 1974, that franchise did not curtail anything at the

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thereof as principal obligors, including any obligation to pay the Government an insurance charge in addition to interest, if and as provided in any such instrument.

. . . .

This agreement shall be subject to present regulations of the Farmers Home Administration and to its future regulations which are not inconsistent with the express provisions hereof.

time. In fact, it brought another wholesale customer into the fold served at the time by Geneva and later by Jennings.

On the other hand, we might see the 1974 franchise grant as the basis for the presently proposed improvement of CSL's facilities so that CSL can provide most of its own raw water. It seems far-fetched, however, to attribute to the 1974 franchise grant, which originally increased the demand for water, a "curtailment" when CSL proposes to improve its own facilities. Instead we might hypothesize that CSL will be granted some new "franchise" when it receives regulatory authority to improve its own facilities. The basic question, it seems to us, is whether this grant of regulatory authority in the 1990s—which indubitably is the event producing the curtailment, if there is one—is in the words of the statute "the granting of any private franchise for similar service."

In ordinary parlance, we would say that it is not. The "granting of any private franchise for similar service" suggests a grant to a third party (competing) supplier—not merely the granting of permission to a wholesale customer to improve its own facilities. The granting of a franchise may mean different things in different contexts, principally because the term "franchise" is not amenable to precise definition. *See* Joseph Joyce, A Treatise on Franchises § 9, at 19 (1909) ("[T]he word 'franchise' has various meanings, and it is difficult to define the term as used under constitutions and statutes, since, as a rule, it is a question of construction in each particular case precluding any definition applicable to all cases."); 36 Am. Jur. 2D *Franchises* § 1, at 722 (1968) ("Many attempts have been made to define it, and there is not a little variation in the terms used."); 37 C.J.S. *Franchises* § 1a, at 142-43 (1943) ("The term 'franchise' has been used in various senses."). Generally speaking, a franchise may be defined as a privilege granted by the government to a company or individual to transact a particular kind of business, as in the case of a privilege granted to a water-

works company to supply a municipality with water and to collect water rates for the use of the water supplied. *See* Paul J. Garfield & Wallace F. Lovejoy, Public Utility Economics 28 (1964). We think the franchise contemplated by section 1926(b) is the privilege *to serve customers*. This conclusion is suggested by, among other things, the fact that the word "franchise" is modified by the phrase "for similar service." The question is, "Similar" to what? Here we think the phrase means similar to the service provided to customers by a rural water association within its service area. The statute forbids encroachment on the water association's service area in either of two ways: (1) through expansion of a municipal or other public water system or (2) through introduction of new or expanded service by a private supplier. Thus both clauses of the statute prohibit another supplier (whether public or private) from being substituted for, and from displacing, the service of the rural water association. Now the crucial question before us is whether new or expanded service by a private supplier includes CSL's development of its own water resources to reduce or eliminate its dependence on an outside water source. We do not believe that the language of the statute taken in context reaches this extreme application. *Cf. Jennings I*, 895 F.2d at 318 n.6 ("[S]ection 1926(b) absolutely bars any encroachment by a *competing water system* on a rural water system indebted to the FmHA.") (emphasis supplied); *Pinehurst Enter., Inc. v. Town of Southern Pines*, 690 F. Supp. 444, 452 (M.D.N.C. 1988) (section 1926(b) does not prohibit municipality from providing sewage collection service in area in which FmHA-indebted association provides sewage treatment service because municipality would not be competing with FmHA-indebted association), *aff'd*, 887 F.2d 1080 (4th Cir. 1989).

The cases and fragments of legislative history available to us all seem to have in mind curtailment resulting from substitution of some third party as a water-supplier for Jennings. *See Jennings I*, 895 F.2d at 315 (entity pur-

chasing water from rural association cannot contract with municipality to replace association as its supplier of water); *Glenpool Utilities Auth. v. Creek County Rural Water Dist. No. 2*, 861 F.2d 1211, 1214 (10th Cir. 1988) (municipality cannot replace rural association as supplier of water by annexing area served by the association), *cert. denied*, 490 U.S. 1067 (1989); *Bear Creek*, 816 F.2d at 1059 (municipality cannot substitute itself as supplier of water for area served by rural association by condemning rural association's facilities); *Moore Bayou Water Ass'n, Inc. v. Town of Jonestown*, 628 F. Supp. 1367, 1370 (N.D. Miss. 1986) (same); S. Rep. No. 566, 87th Cong., 1st Sess., *reprinted in* 1961 U.S.C.C.A.N. 2243, 2309 [hereinafter Senate Report] ("[Section 1926(b)] has been added to assist in protecting the territory served by . . . [a rural water] association against competitive facilities, which might otherwise be developed with the expansion of municipal and other public bodies into an area served by the rural system."). We are aware that the statute is to be interpreted broadly, *see Jennings I*, 895 F.2d at 315 (citing Senate Report, *supra*, at 2305, 2309), but we think there is no fair implication by which it can be said to reach improvement by a wholesale customer of its own facilities so as to reduce the amount of water it must purchase at wholesale.[2] If Congress had in mind *any* authorized construction or development which would reduce demand for the rural association's water, it could easily have used language broad enough to reach that broadly defined activity.

Jennings essentially takes the position that any change in a water system, *which requires regulatory approval*, and which reduces the demand on the wholesale supplier, is prohibited by the statute. Jennings asserts that the Indiana Department of Environmental Management is required to issue permits to CSL to build the proposed

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[2] In general, we think that a franchise to serve at retail carries with it power to vertically integrate to provide for a water supply.

reservoir and water purification facilities, *see* Ind. Code § 13-7-4-1 (1988 & 1992 Supp.), and that the Indiana Utility Regulatory Commission must issue certificates of construction to CSL authorizing the new facilities, *see* Ind. Code § 8-1-2-86 (1988). According to Jennings, the granting of these permits and certificates amounts to the "granting of a franchise."

Jennings concedes that the digging of wells by a farmer, who is an ultimate water customer (and not a reseller), would not involve the "granting of a franchise" although by using water from his own wells the farmer obviously would reduce overall demand for the rural association's water. But Jennings takes the position that similar activity involving the construction of water purification and delivery facilities by a utility that buys water at wholesale and provides retail water service would entail the granting of a franchise *if regulatory approval were required.* The requirement of approval by a public agency seems to be the *sine qua non.*

We believe this is too broad a reading of the phrase, "granting of any private franchise for similar service." As we have indicated, the grant of a "franchise," as that term is used in section 1926(b), must involve service to customers—either provision of existing service to new customers or provision of new or different service to existing customers. Here the grant to CSL of permission to build additional facilities would not confer a right to serve new customers or to provide a new or different service. The permission to CSL would be to authorize it to provide its accustomed service, but in a somewhat different fashion. Instead of buying all its water from Jennings, CSL would provide some from its own resources. There would be no change in the service received by CSL's retail customers and no new customers would be served.

Moreover, viewed from a slightly different perspective, Jennings' argument confuses the *grant* of a franchise with

the *exercise* of a franchise. The grant of a privilege to serve customers is the grant of a franchise; serving customers by providing them with self-produced water (or water purchased at wholesale) is the exercise of a franchise. *See* Joyce, *supra*, §§ 40, 47-48. CSL was granted its franchise in 1974. Should CSL secure an environmental permit and certificates of construction, it will be able to exercise its franchise in a particular (and new) fashion —by supplying and delivering its own water. But even if CSL is unable to secure the necessary certificates and permit, it will retain its privilege to serve its customers (its "franchise") by supplying them with water purchased from Jennings.

Jennings, of course, argues that from an economic point of view it makes no difference whether CSL buys some of its water from North Vernon or supplies the same amount of water from its own wells—the demand for Jennings' water is equally reduced. But by its plain terms the statute does not apply to *any* change in CSL's water system requiring regulatory approval; it applies only to curtailments resulting from the "granting of any private franchise for similar service." If we were to construe the statute as broadly as Jennings demands, we would be precluding any development by water utilities of their own water resources as long as a government loan were outstanding to their wholesale supplier. Such an onerous restriction could freeze any self-development for many decades. Jennings' interpretation seems to us to be an extraordinary restrictive and anticompetitive reading—one that simply cannot find support in the language of the statute. No doubt the statute is intended to be broadly protectionist, but there are degrees of protectionism which its plain language does not reach.

It may also be argued that CSL has waived the "granting of a franchise" issue. In its reply brief, it states:

> [T]his Court must find that CSL Utilities is a private franchise. As correctly stated by Jennings, CSL Util-

> ities admits this portion of the private franchise restriction.

Reply Br. at 4.

But in its main brief, CSL has a whole point with the heading.

> THE CONSTRUCTION OF A WATER FACILITY BY A UTILITY DOES NOT CONSTITUTE THE GRANTING OF A PRIVATE FRANCHISE.

Appellants' Br. at 14.

Of course, CSL is (or operates under) a private franchise. No one contests this. But the more relevant question is whether the granting of a franchise results in a curtailment of the service provided by Jennings. This issue has not been waived.

As we noted in *Jennings I*, the legislative history of the statute confirms that Congress intended section 1926(b) to be read broadly, 895 F.2d at 315 (citing Senate Report, *supra*, at 2305, 2309), and federal courts construing the statute have accordingly interpreted it liberally to protect FmHA-indebted rural water associations. 895 F.2d at 315 (citing, *inter alia*, *Glenpool*, 861 F.2d at 1214 (section 1926(b) prohibits municipality's encroachment on association's service by annexation of territory) and *Bear Creek*, 816 F.2d at 1061 (section 1926(b) forbids municipal condemnation of association facilities)). This is not to say, however, that a government loan to a rural water association can totally freeze retail water utility development within the indebted association's service area. Some development is permissible even though the granting of a franchise or the inclusion of the service area within municipal boundaries are precluded.

Section 1926(b) is, of course, aimed at suppressing competition with a supplier endowed with public funds. *See, e.g., Rural Water Dist. No. 3 v. Owasso Utilities Auth.*, 530 F. Supp. 818, 824 (N.D. Okla. 1979) (sec-

tion 1926(b) prohibits municipalities' exercise of their powers to sell water "when their exercise would result in competition with a Rural Water District"); Senate Report, *supra*, at 2309 (stating section 1926(b)'s purpose "to assist in protecting the territory served by such an association facility against competitive facilities"). But CSL argues persuasively that the district court's construction of section 1926(b) imposes a significant and seemingly unfair hardship upon the utility by denying it the right to develop its own facilities to service its existing customers more economically. We believe that the language of the statute, while it should be broadly construed, does not, in its present form, support what seems to be such an extreme application.[3]

III.

CSL's contention that the facility's construction does not involve the granting of a private franchise during the term of the loan appears to be dispostive. We therefore REVERSE the district court's grant of Jennings' motion for summary judgment and REMAND for further proceedings.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

[3] As to CSL's contention that under the district court's interpretation, section 1926(b) violates the Takings Clause of the Fifth Amendment, we agree with the district court that the argument lacks merit.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

February 25, 1994

Before

Hon. Richard D. Cudahy, Circuit Judge

Hon. Joel M. Flaum, Circuit Judge

Hon. Daniel A. Manion, Circuit Judge

No. 88 C 1151

No. 92-3026

CSL UTILITIES, INCORPORATED and
CSL COMMUNITY ASSOCIATION, INCORPORATED,
Plaintiffs-Appellants,

v.

JENNINGS WATER, INCORPORATED,
Defendant-Appellee.

Appeal from the United States District Court for the
Southern District of Indiana, Indianapolis Division

Sarah Evans Barker, Chief Judge

This matter comes before the court for its consideration of Appellee's PETITION FOR REHEARING, Appellant's RESPONSE TO MOTION TO RECONSIDER, and Appellee's REPLY TO APPELLANTS' RESPONSE TO APPELLEE'S PETITION FOR REHEARING. All of the judges on the original panel have voted to deny a rehearing.

Accordingly, IT IS ORDERED that Appellant's PETITION FOR REHEARING is DENIED.

IT IS FURTHER ORDERED that the court's opinion, issued on December 15, 1993, is modified as follows:

The word "nonprofit" is removed from the first line on page one, and is replaced with the words "privately owned."

Peter C. King, Esq.
CLINE, KING & KING
P.O. Box 250
Columbus, IN 17202-250
92-3026

Enclosed is a copy of a document issued by this court in the above captioned case. Since this will be the only copy your firm will receive, if applicable, please circulate this order to other members of your firm who may have an interest in this case.